THE EXCESS PROFITS TAX—DISCUSSION

David Friday.—Nothing which I have read for some time has given me such satisfaction as the statement in Dr. Haig's paper that the British do not intend to abandon their profits tax. A tax on differential profits was an experiment that many of us had wished to see tried, even before the European war. It seemed an utterly vain hope until the exigencies of war finance brought the thing into being in England and later in this country. I hope that it will be continued, and believe that if the facts with respect to profits are fairly and honestly disclosed to the public, there will be a general demand for its continuance.

We had long suspected that the workings of the price system played queer pranks when it came to the distribution of incomes and of wealth. In an industrial society so complex as ours, subject to the effects of wind and weather, of wars and rumors of war, and of the business cycle, the results of the price system upon profits were suspected to be not simple, uniform, and predictable,—normal if you please,—but to result in variations in profits and incomes that were largely fortuitous. To correct this accidental by-product of the workings of markets, competitive and otherwise, many of us favored a tax on differential profits.

That our suspicions with respect to the lack of uniformity in the ratio of profits to capital and in the predictability of those profits were warranted, at least for the period of the war, is proven by the statistical by-product of the tax. A glance at Table I will make this clear.

Table I.—Percentage of Net Income to Invested Capital: 1917
(*1244 Corporations*)

Per cent earned on capital	Mining and manufacturing		Mercantile		Railroads and public utilities		Financial	
	No.	Net income	No.	Net income	No.	Net income	No.	Net income
		($ 000)		($ 000)		($ 000)		($ 000)
Under 10	177	56,787	78	18,567	88	350,418	24	7,237
10 to 15	110	180,679	49	51,462	12	71,112	14	16,305
15 to 20	132	317,973	46	52,286	3	21,019	3	717
20 to 25	92	318,452	30	77,080	3	2,007	3	3,063
25 to 30	75	172,366	21	6,854	0	.....	0	.....
30 to 40	85	461,941	22	8,995	0	.....	0	.....
40 to 50	48	1,079,590	11	6,792	0	.....	0	.....
50 to 75	49	151,036	12	27,129	1	2,493	0	.....
75 to 100	16	35,758	4	189	3	18,282	0	.....
Over 100	19	54,352	11	10,180	2	1,310	1	123
Total	803	2,828,934	284	259,533	112	466,640	45	27,444
Income tax....		28,233		5,015		14,306		54
Excess profits tax		548,124		31,751		13,443		1,054
Total		576,357		36,766		27,749		1,108
Per cent of taxes to net income		20		14		6		4

What is the normal rate of profits for the 803 mining and manufacturing corporations in this table? The mercantile corporations show more uniformity. They seem to group more closely around 20 per cent, but surely any such spread as is evidenced by the figures for this group is not consonant with the theory of normality even for the corporations lying between 10 and 25 per cent, to say nothing of the group earnings between 50 and 75 per cent. If any further proof is needed of the wide variation in the per cent of income to invested capital see the testimony of Secretary McAdoo before the Ways and Means Committee, August 14, 1918, page 2029, and of Professor T. S. Adams, same day and place, page 2039.

But Table I shows the earnings for a year in which war profits were enormous. The incomes reported by all corporations of the United States rose from $4,300,000,000 in 1913, the highest prewar year, to $8,600,000,000 in 1916 and to $10,700,000,000 in 1917. The profits for 1917 may, therefore, fairly be said to have been abnormal. But investigation shows that while the range of profits is different in the prewar years, the variation is almost as great. Table II and Table III, as well as Table IV, reveal this.

TABLE II.—PREWAR PROFITS: 1911-1913
(3402 Corporations)

Per cent earned on capital	Number of corporations	Earnings exceed expenses
7 to 8	74	$13,924,565
8 to 9	158	20,019,366
9 to 10	266	26,698,860
10 to 11	235	39,182,492
11 to 12	267	31,654,480
12 to 13	244	13,550,727
13 to 14	188	20,360,554
14 to 15	196	13,127,724
Over 15	1,774	169,646,931
Total	3,402	$348,165,699

TABLE III.—RATIO OF EARNINGS TO INVESTMENT[1]
(158 Industrial Corporations. Total Investment, $406,830,000)

Per cent earned	Number of corporations	Per cent earned	Number of corporations
Less than 6	19	15 to 20	26
6 to 8	18	20 to 25	16
8 to 10	20	25 to 30	11
10 to 12	11	30 to 40	7
12 to 15	16	Over 40	10

[1] Data from J. E. Sterrett: "Yield on Trade and Public Service Investment," *American Economic Review*, Mar., 1916.

TABLE IV.—RATIO OF EARNINGS TO INVESTMENT OF 237 SHOE MANUFACTURING COMPANIES[1]

Amount of investment	Number of companies	Per cent earned			
		1914	1915	1916	1917
Under $100,000	85	12.8	14.6	31.5	26.5
$100,000 to $250,000	56	16.7	15.8	25.2	22.5
$250,000 to $1,000,000	74	15.5	15.2	26.6	25.0
$1,000,000 to $3,000,000	14	15.0	15.5	26.3	20.3
Over $3,000,000	8	14.7	14.6	25.4	26.3
Total	237	15.1	15.0	26.1	24.7

[1] Data from Report of Federal Trade Commission.

TABLE V.—RATES OF EARNINGS ON INVESTMENT OF 15 COMPANIES INCLUDED IN TABLE IV.

Company number	1914	1915	1916	1917
1	*—6.80*	*—15.76*	.98	29.03
2	20.92	41.80	38.36	24.15
3	4.94	9.16	12.32	6.83
4	16.89	24.52	43.13	15.44
5	20.65	10.67	29.92	9.06
6	24.61	52.67	72.07	23.68
7	*—4.70*	49.70	*—5.80*	*—28.21*
8	15.83	14.03	18.09	18.82
9	.30	*—3.35*	4.53	4.95
10	7.82	14.82	37.45	30.14
11	25.66	24.22	26.37	24.22
12	10.88	1.20	14.36	8.66
13	61.33	*—26.03*	88.62	*—24.37*
14	52.99	.36	95.08	62.91
15	17.29	*—6.75*	157.88	142.47

The same thing is shown in another way by an examination of the published earnings of industrial corporations. I have tabulated the earnings of 224 of these for the years 1911 to 1916. The average earnings of these corporations for the five years 1911 to 1915 inclusive were $493,600,000. The lowest earnings of any single year were in 1914 and amounted to $381,000,000; the highest were in 1915, being $663,000,000. When the three highest years for each corporation are taken, it turns out that their average earnings, arrived at by a combination of these three highest years, amounted to $745,400,000, while the average earnings for the two lowest years were only $116,100,000. These statistics leave little doubt that the range of fluctuation in the ratio of income to capital is greater than most of us had expected. Even in the case of so conservative and stable a business as banking, the reports of the Comptroller of the Currency disclose a surprising range of fluctuations. In an industrial system like ours there are, at all times, excess profits, fortuitous in nature. If some portion of these be taken, we leave profits nearer that normal which is assumed to result from the workings of the competitive market.

But the excess profits tax or some other form of tax on differential profits should be continued not merely because it is just and furnishes a much needed correction of the workings of our price system. It is the tax that least impedes enterprise and business activity. Indeed I should like to see the excess profits tax substituted for all other taxes, except the tax on land. Modern business is fraught with a high degree of uncertainty and risk. The state should apportion the burden of taxation so as to minimize this risk as much as possible. This can best be done by requiring people to pay taxes only in years when they have unusually high profits and by relieving them of as much of the burden of taxation as possible in other years. Even in the prosperous year 1917, there were 84,000 corporations whose returns to the Commissioner of Internal Revenue showed no net income and in most cases showed an actual deficit. These corporations had paid state and local taxes amounting to $115,000,000. It would have been more wise and more just to collect this amount from those corporations which showed an income two and one half times as large in that year as in the prewar period.

Finally, as an economist, I should like to see the excess profits tax continued for the sake of its statistical by-product. This could not of itself be a sufficient argument for its continuation, but I confess that it influences my attitude toward the matter. The inadequacy of our data concerning profits is glaring. The excess profits tax returns of 1917 have taught us much, and we shall learn much more from the 1918 returns. If the tax were continued for a decade we should then have data with respect to profits in normal times as well as in war times, and could proceed to formulate a relevant and adequate theory of profits; a theory, that is, which would set forth the principles underlying the causes of fluctuations in business profits for all industries from year to year and from industry to industry in the same year. In 1918 individuals and corporations reported to the Bureau of Internal Revenue net income of $20,000,000,000, after eliminating all duplications. Of this amount $14,500,000,000 consisted of business profits. It is farcical to pretend that we have an adequate explanation of the distribution of wealth and income when we know so little about the underlying principles which determine this share.

George E. Holmes.—If the excess profits tax is to be retained as a source of revenue, perhaps the most important question concerns itself with the improvement of our definition of invested capital. The definition contained in the present statute (Revenue Act of 1918, Sections 325-328) is now generally recognized as very defective. It lays too great emphasis on form; it allows undue advantage to be taken of the accident of reorganization or recapitalization prior to March 3, 1917; it treats intangible property (such as patents, trade-marks, and goodwill) in too arbitrary a fashion; it excludes too much real capital and includes too much apparent capital. The suggestions I offer are five in number, but the same principle underlies all of them, which is that the

definition of invested capital, forming the basis of the tax, should be uniform without regard to whether or not the aggregate amount of invested capital is thereby increased.

1. The total value, as at March 1, 1913, of all the assets used in the business of a corporation in existence on that date should be included in the invested capital of that corporation.

This comprises not only the actual value of the tangible property, but also the value of the intangible property,—goodwill, patents, etc.,—whether or not the asset was carried on the books of the corporation. In this way only can the variety of organizations and methods of financing be placed on the same level. By this means the old, conservative corporation will stand on a parity with the reorganized, perhaps overcapitalized, corporation; the corporation which has not capitalized its intangible assets will not suffer in comparison with the one that has. One great discrimination, if not the greatest, in the present law will be avoided. This is not a new idea. It was suggested when the present statute was in its formative stage, and was discarded at that time for fear that the resulting capitalization would be so great as seriously to reduce the excess profits intended to be reached by the tax. This objection has more apparent than real merit. The amount of revenue should be controlled by the rate of the tax, not by the base. The base should be uniform in its application. It then becomes immaterial whether the base results in a great or small aggregate capitalization, in comparatively big or little taxable excess profits. The rate will take care of the tax; the base will take care of equalizing the burden between taxpayers.

No great administrative difficulty need be feared in determining the value of assets as of March 1, 1913. This is done in many cases today for the purpose of computing the profit on the sale of assets, or depreciation, or depletion. The principles to be followed in ascertaining the value of goodwill are well-established and uniform rules can readily be laid down.

2. Borrowed money should be included in invested capital.

For the purpose of a business tax,—such as the excess profits tax really is,—the real capital used in producing the taxable income should be considered in applying the measure of the tax. Conversely, the interest paid in such indebtedness should be included in the taxable income. Such interest should not be income to a creditor for the purpose of the same tax, nor should the principal sum on which the interest is paid be regarded as invested capital of such creditor. There is no reason, however, why the interest should not be taxable income for purposes of the income tax, and a deductible expense of the debtor for the purpose of such tax. Objection has been made to the inclusion of borrowed money on the ground that it gives rise to administrative difficulties, but it is extremely doubtful if the difficulty of determining what should be included will be greater than determining what should be excluded,—and the present law requires the exclusion of borrowed money. At the present time corporations have in large part

ceased to finance themselves through bond issues and are using preferred stock to accomplish the same purposes. So far as the debtor corporation is concerned, the distinction between bonds and preferred stock is not very great. Both produce working capital. The preference, if any, as to one or the other of the two forms of securities is expressed by the creditor and concerns his relation to other creditors. A prosperous concern has no difficulty in replacing its bonds with preferred stock,—the only disadvantage being in the obligation, generally, to pay a somewhat higher rate for the use of the capital, and this is offset by advantages inherent in preferred stock as against bonds. Preferred stock yielding dividends at a fixed rate and redeemable by the corporation bears a close analogy to borrowed money. To get at a uniform base both borrowed money and preferred stock should be excluded from invested capital, or both should be included. The practical solution seems to lie in including borrowed money rather than excluding preferred stock. This tends again to increase capitalization and reduce excess profits—a matter to be adjusted by the rates of the tax.

3. Only that capital which is actually employed in the business of the taxpayer should be considered as invested capital.

In the Revenue Act of 1917 an attempt was made to limit the amount of surplus and undivided profits which should be included in invested capital to that portion which was actually used and employed in the business. But conflicting provisions of the statute demanded a construction which allowed the inclusion of all capital and surplus except that invested in inadmissible assets. In an excess profits tax law, intended to tax a business, the capital and income of that business alone should be considered; other capital and other income should be excluded. This is the rule in Great Britain,—and no insurmountable difficulties seem to have been encountered there in practice. At present, under our system, a corporation with large accumulations of surplus obtains an undue advantage. It may invest that surplus in bonds yielding a small but safe return, add the capital so invested to its capital actually invested in its business, and the low return of income from investments to the high return from its business. The result is a smaller tax. The inclusion of all the capital and surplus of a corporation in invested capital produces artificial, unsubstantial comparisons between taxpayers. The inclusion of only that capital and surplus which is actually used to create the business income would tend toward making the base of the tax uniform.

4. Intangible property should be taken into invested capital at its actual value on March 1, 1913, or at the date of acquisition.

The treatment of intangible property for purposes of invested capital in the present law produces ridiculous results. The value of such property is made to depend upon the form of the transaction and the date of its consummation. All other things being equal, the difference of a day or two in the time at which stock is issued for intangible property may make a difference of many thousands of dollars in in-

vested capital. If a million dollars of stock is issued on December 31 for patents of equal value, the invested capital for the following year is $250,000 greater than if precisely the same transaction takes place on the following business day. This is an utter disregard of essentials and an arbitrary discrimination which cannot be justified.

Intangible property has a recognized actual value as well as tangible property. It is recognized by the courts and should be given due recognition in a taxing statute of this kind. The actual value at the time of acquisition, without any artificial limitation, should be considered as invested capital if the base of the tax is to be uniform. If the first suggestion I have made were adopted, namely, that the value of all assets on March 1, 1913, be considered as invested capital, the inclusion of the actual value of the intangible property (as that term is defined in the statute) acquired after that date would naturally and consistently follow. Of course mere formal sales or reorganizations should not in any event be allowed to result in the increase of invested capital with respect to either tangible or intangible property; but actual *bona fide* sales establish new values, and under our system of taxing profits the realization of such higher values produces taxable income to the vendor of the property. The Commissioner should be given the greatest latitude in determining when new values should be allowed; his action should be governed by general statutory rules, not specific rules,—and in this there would be no delegation of judicial or legislative power, for invested capital is essentially a question of fact, and the Commissioner's authority lawfully extends to the finding of facts.

5. Earnings arising in the taxable year should be included in invested capital to the extent, and from the time, they are actually and permanently invested in the business.

This again is necessary in order to establish a uniform base. Whether or not earnings of the taxable year are actually and permanently invested in the business is a matter of fact. The presumption in most cases would be that such earnings are merely held for distribution at the end of the year or at a later period. But if it can be shown that a taxpayer has actually invested such earnings in plant, buildings, or machinery, due allowance should be made for the fact that this is an addition to the capital which produces the taxable income. The rule in Great Britain seems to be that the profits accumulating within the period of an account are not to be regarded, during that period, as accumulated profits employed in the business, except so far as a fixed investment in capital assets (for example, the purchase of a plant) is made out of such profits. The British statute, as recently amended, expressly excludes current profits, but it appears that the foregoing rule is nevertheless followed in practice.

In the limited time available it is impracticable to discuss fully the various incidental phases of invested capital, and the remarks I have made are intended merely to indicate some general principles which should be followed in any definition of invested capital. Another

thought, referring more particularly to the rates of the tax, has also occurred to me. If a tax in the nature of an excess profits tax is to be adopted, it might well supplant the income tax on corporations as well as the present excess profits tax. Such a tax should, for the sake of simplicity, be the only tax imposed on corporations. Assuming that the present income tax will apply to individuals and partnerships without material change in principles or rates, it may be conceded that the excess profits tax can properly be limited to corporate incomes. Such tax on corporations might take the form of a graduated income tax based on the relation of income to invested capital. No deduction from the net income, except perhaps $3000, should be allowed before applying the rates. The rates might be, for example, 10 per cent on the amount of net income exceeding $3000 not exceding 6 per cent of the invested capital; and 20 per cent on the amount of net income exceeding 6 per cent of the invested capital. The rates given in this example are merely illustrative, and are not intended to express any opinion as to what rates may be necessary in order to produce the revenue required or proper from the viewpoint of taxpayers. The division of income at an amount equal to 6 per cent of the invested capital is suggested because this is close to the average interest rate and makes less important the question of inclusion or exclusion of assets regarding which there may be doubt as to admissibility, *e.g.*, funds temporarily on deposit in a bank. It would be highly desirable if this point marking the progression of rates could be movable with respect to trades or businesses in which the financial hazard is greater than normal and with respect to which the return on capital invested should be correspondingly higher than normal. This appears to be achieved successfully in Great Britain where the Board of Referees fixes the percentage standard for various trades at a higher rate than the basic percentage standard, which is 6 per cent for corporations. It also seems desirable both from the viewpoint of revenue and of sound economic principle that the graduated rates be limited to two: a comparatively low rate for corporations with fixed or low incomes where the margin between income and outgo is narrow, and a comparatively high rate for others. But the maximum rate should not be so high as to destroy the incentive to make large profits or to encourage extravagant disbursements on the ground that the government in effect bears a large share of the expense,—an attitude fostered and encouraged by our present rates.

Arthur Anderson.—Professor Haig has presented in a remarkably summarized manner the chief points which arise in connection with the question as to whether or not the excess profits tax should be continued as a part of the permanent tax system. From the point of view of both those who favor the continuation of the tax and those who favor its abolishment the thoughts developed in the paper merit careful consideration. With the prospect of an annual national budget, calling for many years to come for the expenditure of upwards of four

times the outlay prior to the war, we are face to face with a heavy tax levy to be met either directly or indirectly. Viewing the situation therefore from its broadest aspects, the question resolves itself into, not whether or no we shall be heavily taxed, but rather the most equitable manner of spreading the burden.

Any influence which the excess profits tax has had on prices is probably secondary and, in a measure, inconsequential. It will be recalled that the upward price tendency reflected itself in the middle and latter part of 1916, and many businesses in that year had larger net profits than in 1917 or 1918, after deducting the excess profits taxes applicable to those years. If the excess profits tax has influenced prices it is due to the extravagance which was invited by the government in 1917 and 1918, indeed if not in 1919, through the high rates of taxation which prevailed in all of those years. Undoubtedly large amounts were expended for repairs, renewals, advertising, salaries, and other items, which would not have been so expended if a large proportion could not have been passed on to the government in the form of reduced taxes. This is, without question, one of the principal arguments that can be properly raised against the continuation of an excess profits tax. It is at least doubtful whether the 1919 rates are not too high and whether unless a reduction is made this evil will not continue. Just what the result would be under more stable and competitive business conditions cannot be forecast, although it is the general view of those who favor the continuation of the excess profits tax that the effect, if any, would not be material.

The success of an excess profits tax in this country will depend more largely upon proper administration of the tax than any other factor. Professor Haig has called our attention to the British plan of a Board of Referees and the pronounced success with which it has met. Furthermore, we are reminded of the aloofness which the Advisory Board had from the Treasury Department in the administration of the 1917 act. It is of course easier to criticise than to construct, but those of us who have had to do with the preparation of cases involving the assessment of substantial amounts feel strongly that the present centralized control by the Treasury Department at Washington will, if continued, tend to weaken the excess profits tax system. The creation of District Boards (probably not less than 12 in number) not unlike the Federal Reserve Boards, with unusually broad powers but nevertheless controlled through the central or main body at Washington, will mend what now appears to be a serious weakness in the present plan of administration. Furthermore, the personnel of such boards should not be made up solely of men with the government's viewpoint any more than of men with purely the interests of the taxpayers in mind. One of the principal reasons why the Advisory Board met with such general favor was the fact that its members represented the different interests, and it was more or less detached from the Treasury Department. The collection of excess profits taxes, being so far-reaching, must be made along such lines as will promote the greatest

possible harmony and coöperation between the government and the taxpayer.

Another important factor appears to be the effect that the excess profits tax has had on the development of industry. The present high rates of taxes (both on corporations and individuals) have prevented the merger of interests. (Right at this juncture it may not be amiss to suggest that it is a serious question whether it is wise to continue the present high rates of surtaxes as applied to individuals.) Many prospective combinations of capital and sales of businesses have not been consummated because of the tax liability involved. In England appreciation, or increase in property values, is not subject to taxation. Apparently appreciation or profit on the sale of capital assets is taxable under all revenue acts passed by Congress and the regulations issued thereunder by the Treasury Department. Many distinguished members of the bar believe that profit on the sale of capital assets is not taxable, either under the 1917 or 1918 revenue act, and have advised their clients to pay that portion of the tax applicable thereto under protest,—if not entirely to omit the item from the return,—so stating on the face of it. Pending a decision upon the part of the United States Supreme Court, and assuming that it is considered wise and that it can be legally done, it appears that a distribution or allocation of such profits over the period during which they accrued and a reassessment of the taxes for those years may be a solution of the problem.

A word should be added to the remarks of Professor Haig covering a possible "graduated scale of income taxes," presumably without reference to invested capital. If taxes should be assessed on "ability to pay," mere size of income is not the only point to be considered. The corporation with a large invested capital and relatively small income would be discriminated against as compared with a corporation having the same income but a small investment. There would also be a more direct tendency in such a case to regard the tax levied as part of the cost of the product.

It is highly important that a definite tax program, which will be effective a year hence, be adopted as early as practicable. It is exceedingly unwise to enact retroactive tax laws. American taxpayers should know just what may be expected of them over a period of years.

THOMAS E. LYONS.—Any consideration of the repeal or abandonment of the excess profits tax must face the fact that the federal government will require an aggregate revenue of from four billion to six billion dollars annually for several years to come. The annual expenditure prior to the war was about $1,200,000,000. It is probable that, with the greatly increased cost of labor and supplies, the same service would now cost from 30 to 50 per cent more. In the meantime governmental activities have greatly increased, and the annual expenditure for ordinary administration cannot now fall much below two billion dollars. There is a strong prospect of a material increase of the

army and navy, and a heavy deficit is to be met resulting from the government operation of railroads and other public utilities which will probably mean a billion dollars more. The yearly interest on the public debt will approach another billion, so that the annual expenditure for these purposes alone will approximate four billion dollars. If any substantial part of the principal is retired, an additional levy of from one to two billion dollars will be necessary.

The aggregate receipts of the Internal Revenue Department for the year 1918, under the war revenue act of 1917, were, in round numbers, $3,700,000,000, and the aggregate receipts for the year ending July 1, 1919, under the revenue act of 1918, were $3,850,000,000. The excess profits and income taxes assessed during that year are payable in installments and the Commissioner of Internal Revenue estimates that receipts from these deferred payments and other sources will yield two billions additional, or $5,850,000,000 in all.

It should be borne in mind that these large revenues were derived from the inflated incomes of 1917 and 1918, which, according to the figures presented by Professor Friday, have already begun to decline, and will probably continue to do so. The rates of both the income and excess profits taxes applicable to 1919 income are substantially lower than those applicable to the income of preceding years, and a consequent reduction of revenue will result. It will be observed that the revenue laws of 1917 and 1918, although based on war time income, were strained to the limit to yield the amounts above stated. With reduced rates and a reduced aggregate income, the yield for coming years, even if the present revenue law be retained, must show substantial reduction.

The income and excess profits taxes of 1917 and 1918 produced approximately 60 per cent of the total revenue collected, and the excess profits tax alone yielded not less than 35 per cent of the total in each of these years. If that is repealed, where shall we turn for a substitute? The bulk of the loss resulting from the repeal of the excess profits tax would have to be produced by the income tax, and this would require either a reduction of exemptions or an increase of rates or both. Little reliance may be placed on the reduction of exemptions, because that course would enormously increase the opposition to the tax and produce comparatively little revenue. This is shown by the fact that of the 3,400,000 persons and corporations who paid income or excess profits taxes in 1918, 2,300,000 paid an average tax of less than ten dollars apiece. The total revenue from this great number of small taxpayers was less than $23,000,000. Prospect of any material revenue from this source may, therefore, be dismissed. Neither does it seem possible to increase the normal surtax rates, already high, sufficiently to make good the loss that would result from the repeal of the excess profits tax.

It has been suggested that consumption taxes may be extended and increased, but in the present temper of the people this course would encounter strong opposition as shifting the burden from so-called big

business and profiteers to small taxpayers. The widespread impression that those who profited most by the war have contributed little to its cost may be erroneous, and in many cases unjust, but the impression is abroad and Congress will not fail to note it. They certainly have not escaped heavy taxes, but the figures presented by Professor Friday as to the stupendous incomes realized and the large profits remaining after payment of these taxes are amply sufficient to explain the popular suspicion. These considerations will not be ignored, nor fail to have influence when a new revenue bill is being framed. The choice is not between a revenue system such as this Association may recommend and the present law, but between the present system and that which Congress will substitute in its place. If we could be assured of such a revenue bill as Dr. Adams would frame and this Association approve, I would accept it without reservation, but such a bill and that which Congress will enact are two very different things.

In this state of uncertainty, and in view of the fiscal needs of the government for several years to come, is it not the part of wisdom to devote our energies to improving the present law, which has proved so great a revenue producer, instead of venturing into a new and untried field? Taxpayers have become accustomed to the law as it stands, and notwithstanding the vehement propaganda now being carried on, it has not proved a serious hardship or embarrassment to business. It does not impose a large tax upon any one who has not had a large income. No one claims that the present system is perfect, nor doubts that a better balanced and more equitable one could be devised, but, as before stated, the choice lies between what we now have and what we are likely to get. In that situation, I have no hesitation in taking my stand in favor of retaining the present system, for the time being at least, and improving its provisions so as to eliminate the most pronounced inequalities, as against an attempt to secure a new and different law, the character, terms, and yield of which are problematic and unknown.

Roy G. Blakey.—I agree with Professor Adams that there is grave danger of discrediting the excess profits tax and also the income tax unless their administration can be radically improved. In other words, there is much danger that we shall retrograde rather than progress in the matter of taxation unless very wise changes are made. If this new taxation is thoroughly discredited it may be very difficult to revive it in cases of great need or emergency.

In proposing remedies, however, we are confronted with a dilemma. On the one hand, it seems almost impossible to make adequate improvements in the administration of the existing taxes; on the other hand, it seems improbable that other taxes which will raise as much revenue will be administered any better or be any more equitable. Another possibility is to reduce taxation very radically and resort to further borrowing, but to those who see far and clearly this is the worst kind of taxation that could be proposed.

The first and fundamental fact is that we must have large revenues from some source and somebody must pay them, however painful that may be. The immensity and the relative newness of the task of administering the present excess profits tax result in a breakdown in the face of peace-time psychology and the cumbersome civil service machine. To turn from the excess profits tax to an equivalent increase in the income tax gives no promise of better results. To substitute a tariff which would be fiscally adequate is impossible. Though such an attempt would probably gladden the hearts of many standpat protectionists, no socially-minded economist could stomach it, even if it could be made fiscally adequate.

It is possible, however, to make some improvements in the law, and it should be possible to revive the Tax Advisory Board and to make some substantial improvements in the personnel, quality, and size of the staff that administers the law. To hope that Congress will reform itself so that it can reform the civil service and make it efficient is to exhibit an excessive amount of faith in congressmen and also in the people who choose congressmen. But I do not see that we can do any better than to make the best of this discouraging situation and continue an improved excess profits tax because other alternatives appear worse.

When Professor Adams argues that the excess profits tax has little or no effect upon prices and the cost of living, I disagree emphatically. That manufacturers and dealers raise prices because they pay this tax is not the important consideration, as Professor Adams seems to imply. As he says, they make their prices as high as seems wise and profitable regardless of the tax and such a tax is not an expense of business entering into competitive costs. What is more important in this connection is that the large corporate and individual surpluses and incomes thus paid to the government in taxes are not available for investment in plant extension, and thus future production of goods is reduced and prices raised. Furthermore, people of relatively small means are thus relieved of taxation and those whose money incomes have increased indulge in victrolas, furs, jewelry, automobiles, etc., as they have never done before. Their buying of such goods has not only helped to increase the prices of luxuries and semi-luxuries, but has diverted much productive capacity from the making of necessaries. Consequently all of us pay high prices.

Most of the capital saved in the recent past has been by corporations and people with large incomes. It seems almost certain that our material progress will be much retarded in the future unless the masses can be educated to increase their savings and thus make up in some part for what the government takes from those with large incomes in the form of heavy taxes.

In considering the effect upon prices, we should add to the above the waste and extravagance caused by high taxes. Large bonuses, extravagant advertising campaigns, and all sorts of questionable undertakings are entered upon when one argues, "Oh well, the government will

pay half or two-thirds of the cost anyway; maybe I'll get something out of it in later years when taxes are lower, and the chance is worth the third or half of the cost which falls on me."

Among many features of the federal excess profits and income taxes which need amending, there is one that is so grossly unjust that I will take time to mention it. For example, if a property was bought for $100,000 in 1913 and sold for $150,000 in 1918, and if there were no income or expense in connection with it in the meantime, or if the expenses equalled the income, then the $50,000 advance in price is considered taxable income for the year 1918. There is a double inequity in this. First, the $50,000 should not all be allotted to the year 1918 and the high tax rates of that year applied to the entire amount. Any increase in value should be distributed over all of the years in which it occurred and not all be taxed in the year of sale. In the second place, while there was an apparent value increase of $50,000 in this case, there was no real income, there was merely an increase in price, there was no increase in value. The purchasing power of the $150,000 in terms of goods was less in 1918 than was that of $100,000 in 1913. Under existing conditions, it is probably impracticable to make all of the adjustments that would be necessary if the administrators of the law were required to make accurate allowances for changes in prices, but both legislators and interpreting administrators should take sufficient cognizance of such facts to make the law and its administration as equitable as possible. Even with all the obstacles that exist, much improvement is yet possible.